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No. _____

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

MARYLAND NATIONAL BANK

Appellant

v.

STATE DEPARTMENT OF ASSESSMENTS AND TAXATION

Appellee

On Appeal from the Court of Appeals of Maryland

JURISDICTIONAL STATEMENT

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QUESTIONS PRESENTED

At issue in this case is whether the State of Maryland is permitted to include interest earned on Federal Home Loan Bank bonds in the measure of the franchise tax which Maryland, by statute, imposes on financial institutions. The questions presented in this case are:

1. Whether the Maryland statute requiring interest earned on Federal Home Loan Bank bonds to be included in measuring the Maryland franchise tax violates 12 U.S.C. §1433, exempting such bonds both as to principal and interest from all state taxation (except surtaxes, estate, inheritance, and gift taxes) and is therefore invalid under the Supremacy Clause.

2. Whether Federal Home Loan Bank bonds are "obligations of the United States Government" under 31 U.S.C. §3124(a) when Congress expressly provided in 12 U.S.C. §1435 that such bonds are "not obligations of the United States", and such bonds are not backed by the full faith and credit of the United States.

3. Assuming that 31 U.S.C. §3124(a) applies at all, whether the exemption provided by 12 U.S.C. §1433 of Federal Home Loan Bank bonds from all state taxation (except surtaxes, estate, inheritance, and gift taxes) is broader than the exemption provided in 31 U.S.C. §3124(a) allowing nondiscriminatory franchise taxes on obligations of the United States.

CORPORATE PARTY'S AFFILIATIONS

Appellant's parent company is MNC Financial, Inc. Other affiliates of Appellant (other than wholly owned subsidiaries) are:

American Security Corporation (District of Columbia)
American Security Bank, N.A. (United States)
American Security Louisiana, Limited (District of Columbia)
American Security Bank International (Nassau)
American Security Capital Corporation (Delaware)
American Security Insurance Corporation (Maryland)
American Security Investment Services (Delaware)
American Security Financial Center, Inc. (Delaware)
American Security Investments, Inc. (Delaware)
ASB Capital Management, Inc. (Delaware)
ASB Southwest Corporation (Delaware)
Maryland National Affiliates Corporation (Maryland)
Maryland National Leasing Corporation (Maryland)
American Financial Service Group, Inc. (Michigan)
Marnat Leasing Corporation No. 1 (Maryland)
Marnat Leasing Corporation No. 2 (Maryland)
Marnat Leasing Corporation No. 3 (Maryland)
Marnat Leasing Corporation No. 4 (Maryland)
Marnat Leasing Corporation No. 5 (Maryland)
Maryland National Leasecorp (Maryland)
Maryland National Leasing Services Corporation (Maryland)
Maryland National Mortgage Corporation (Maryland)
C.M. Brown & Co., Inc. (New Jersey)
MN World Trade Corporation (Maryland)
MNC Commercial Corporation (Maryland)
MNC Capital Corporation (Maryland)

Maryland National Realty Investors, Inc. (Maryland)
National Personal Finance Corporation (Maryland)
American Consumer Discount Company (Pennsylvania)
American Industrial Bank (Colorado)
American Industrial Bank of Arvada (Colorado)
American Industrial Bank of Aurora (Colorado)
American Industrial Bank of Cherry Creek (Colorado)
American Industrial Bank of Lakewood (Colorado)
Homeowners Loan Corporation (Maryland)
Homeowners Loan Corporation (New Jersey)
Homeowners Loan Corporation (Pennsylvania)
Homeowners Loan Corporation (Virginia)
Mid-Atlantic Life Insurance Company (Arizona)
National Consumer Discount Company (Pennsylvania)
Maryland Bank, N.A. (United States)
Greenburgh Marco, Inc. (New York)
Rehold, Inc. (Florida)
Reland, Inc. (Maryland)
Reprise, Inc. (Maryland)
Maryland National Insurance Company, Inc. (Maryland)
Maryland National Investment Corporation (Maryland)
Maryland National Pennsylvania Corporation (Maryland)
MN Credit Corporation (Maryland)
MN Services Corporation (Maryland)
MNC Financial, Inc. (Delaware)
MNC Financial-Corporate Services Group, Inc. (Maryland)
Recap, Inc. (Delaware)
Redwood Realty Corporation (Maryland)

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On Appeal from the Court of Appeals of Maryland

JURISDICTIONAL STATEMENT

Appellant, Maryland National Bank, appeals from the final judgment of the Court of Appeals of Maryland entered October 6, 1987, upholding the validity of a Maryland statute, Md. Ann. Code, art. 81, §128A (1980 Repl. Vol.). Maryland National Bank had challenged that statute on the ground that it violates the laws of the United States and is repugnant to the Constitution of the United States.

OPINIONS BELOW

The Opinion of the Court of Appeals of Maryland, reported at 310 Md. 664, 531 A.2d 294 (1987), is reproduced in the Appendix hereto, pp. 1a-13a.

The Memorandum Opinion and Order of the Circuit Court for Baltimore City, entered October 2, 1986,

from which the appeal to the Court of Appeals was taken, is not reported, but is reproduced in the Appendix, pp. 14a-25a. The Order and Memorandum of Grounds for Decision of the Maryland Tax Court, entered December 13, 1985, from which the appeal to the Circuit Court for Baltimore City was taken, is not reported, but is reproduced in the Appendix, pp. 26a-33a.

JURISDICTION

The final judgment of the Court of Appeals of Maryland (App., pp. 1a-13a), which had the effect of denying Maryland National Bank a franchise tax refund, was entered October 6, 1987. That judgment upheld the validity of a Maryland statute, Md. Ann. Code, art. 81, §128A(b) (1980 Repl. Vol.), challenged by Maryland National Bank as being in violation of the laws of the United States and repugnant to the Constitution of the United States. Notice of Appeal (App., pp. 36a-37a) was filed in the Court of Appeals of Maryland on November 27, 1987. The jurisdiction of this Court is invoked under 28 U.S.C. §1257(2). *See Rockford Life Ins. Co. v. Illinois Dept. of Revenue*, ___U.S. ___, 107 S.Ct. 2312, 2314 n.3 (1987); *First Nat'l Bank of Atlanta v. Bartow County Board of Tax Assessors*, 470 U.S. 583 (1985); *Memphis Bank & Trust Co. v. Garner*, 459 U.S. 392, 395 (1983).

CONSTITUTIONAL PROVISIONS AND STATUTES INVOLVED

Constitution of the United States, Article VI, Clause 2: This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the

Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the contrary notwithstanding.

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12 U.S.C. §1433

Any and all notes, debentures, bonds, and other such obligations issued by any bank, and consolidated Federal Home Loan Bank bonds and debentures, shall be exempt both as to principal and interest from all taxation (except surtaxes, estate, inheritance, and gift taxes) now or hereafter imposed by the United States, by any Territory, dependency, or possession thereof, or by any State, county, municipality, or local taxing authority. The bank, including its franchise, its capital, reserves, and surplus, its advances, and its income, shall be exempt from all taxation now or hereafter imposed by the United States, by any Territory, dependency, or possession thereof, or by any State, county, municipality, or local taxing authority; except that any real property of the bank shall be subject to State, Territorial, county, municipal, or local taxation to the same extent according to its value as other real property is taxed. The notes, debentures, and bonds issued by any bank, with unearned coupons attached, shall be accepted at par by such bank in payment of or as a credit against the obligation of any homeowner debtor of such bank. (Footnote omitted).

12 U.S.C. §1435

Obligations of the Federal Home Loan Banks issued with the approval of the board under this chapter

shall be lawful investments, and may be accepted as security, for all fiduciary, trust, and public funds the investment or deposit of which shall be under the authority or control of the United States or any officer or officers thereof. The Federal Reserve banks are authorized to act as depositaries, custodians, and/or fiscal agents for Federal Home Loan Banks in the general performance of their powers under this chapter. All obligations of Federal Home Loan Banks shall plainly state that such obligations are not obligations of the United States and are not guaranteed by the United States.

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31 U.S.C. §742

(Current version at 31 U.S.C. §3124(a))

Except as otherwise provided by law, all stocks, bonds, Treasury notes, and other obligations of the United States, shall be exempt from taxation by or under State or municipal or local authority. This exemption extends to every form of taxation that would require that either the obligations or the interest thereon, or both, be considered, directly or indirectly, in the computation of the tax, except nondiscriminatory franchise or other nonproperty taxes in lieu thereof imposed on corporations and except estate taxes or inheritance taxes.

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31 U.S.C. §3124(a)

(a) Stocks and obligations of the United States Government are exempt from taxation by a State or po-

litical subdivision of a State. The exemption applies to each form of taxation that would require the obligation, the interest on the obligation, or both, to be considered in computing a tax, except—

(1) a nondiscriminatory franchise tax or another nonproperty tax instead of a franchise tax, imposed on a corporation; and

(2) an estate or inheritance tax.

Annotated Code of Maryland, Article 81, §128A (1980 Repl. Vol.) provides in pertinent part:

(a) *Tax Levied; "financial institution" defined*—A franchise tax is hereby annually levied for each fiscal year of the State beginning after June 30, 1968, upon every domestic financial institution for the privilege of existing as a corporation during any part of the State's fiscal year, and upon every financial institution organized under the laws of the United States or another state or nation for the grant to it of the privilege in corporate or organized form of transacting or for the actual transaction by it of any business within this State * * *.

(b) *Tax Measured by net earnings; "net earnings" defined*—The tax imposed by this section shall be measured by the net earnings of such financial institution for the taxpayer's annual accounting period * * *. "Net earnings" for purposes of this section shall mean the net income of such financial institution for its annual accounting period ending within the fiscal year of the State for which the tax is imposed, determined in accordance with the provisions of §280A of this article * * *; provided, however, that the fi-

nancial institution shall include in its income interest upon obligations of the United States, of any State including Maryland, * * * and of the respective instrumentalities thereof * * *.

(c) *Rate of tax*—The rate of tax shall be seven percent (7%) of net earnings allocable to this State under the provisions of this section * * *.

* * * * *

STATEMENT OF THE CASE

A Maryland statute enacted in 1968[1] imposes a franchise tax on financial institutions, including those organized under the laws of the United States, for the privilege of transacting business as a corporation within the State. Md. Ann. Code, art. 81, §128A(a) (1980 Repl. Vol.). The franchise tax is measured by annual corporate "net earnings" determined according to the same basic formula used in Art. 81, §280A, for determining the Maryland income tax imposed on all other corporations. Art. 81, §128A(b). The 7% rate of each tax is identical. Art. 81, §§128A(c), 288(b),(c). Financial institutions subject to the franchise tax on net earnings are exempt from the corporate income tax. Art. 81, §288(d)(1).

However, there is one major difference relevant to this case. For corporate income tax purposes, "interest income on obligations of the United States and its instrumentalities" is *subtracted* from net earnings. Art. 81, §280A(c)(3). In contrast, "net earnings" for measuring the franchise tax is defined to *include* "in-

[1] 1968 Md. Laws ch. 452, §9.

terest upon obligations of the United States" and "instrumentalities thereof." Art. 81, §128A(b).

The Maryland National Bank (the "Bank") is a corporation organized under the National Bank Act with its principal office in Maryland. For the years 1979 through 1982, the Bank included in its report of net earnings subject to the franchise tax all interest on consolidated bonds of Federal Home Loan Banks ("FHLB"), which 12 U.S.C. §1433 exempts from all State taxation. (App., p. 39a). It then filed timely claims for refund of that portion of the franchise tax measured by interest on FHLB bonds, but its claims were denied on September 10, 1984, by the State Department of Assessments and Taxation (the "State") after a departmental hearing (App., p. 39a).

On October 9, 1984, the Bank appealed this adverse administrative ruling to the Maryland Tax Court.[2] Pursuant to stipulation, the Bank and the State agreed that the sole issue to be decided was whether interest earned on FHLB bonds was required to be included in the measure of the Maryland franchise tax. The stipulation (App., pp. 38a-41a) set forth all facts necessary to resolve the Bank's appeal. Pursuant to the stipulation, the parties further agreed that the tax in question was in fact a franchise tax, that the Bank was subject to the Maryland franchise tax, and that the bonds in question were Consolidated FHLB bonds (App., pp. 39a-40a). The stipulation further specified the amount of refund due to the Bank if interest earned on FHLB bonds was determined to

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[2] The Tax Court is an administrative body established by the Maryland legislature. Md. Ann. Code, art. 81, §224 (1980 Repl. Vol.).

be not includable in the measure of the franchise tax (App., p. 41a).

The questions presented in this case were raised by the Bank in its Memorandum of Law filed in the Maryland Tax Court on June 12, 1985, and during the hearing before that Court on July 24, 1985. The Tax Court held that the plain wording of 12 U.S.C. §1433 prohibited Maryland from including interest earned on FHLB bonds in the measure of the franchise tax (App., p. 29a). The Tax Court reasoned that "Congress said what it meant when it wrote that only surtaxes, estate, inheritance, and gift taxes may be imposed directly or indirectly on Federal Home Loan Bank Bonds." (App., p. 32a). The Tax Court further held that 31 U.S.C. §3124(a) was not applicable so as to permit Maryland to include interest earned on FHLB bonds in the measure of the franchise tax. It stated that "even if the phrase 'other obligations of the United States' could be construed to include Federal Home Loan Bank Bonds, it is an accepted rule of statutory interpretation that the more specific provisions of 12 U.S.C. §1433 would control the general provisions of 31 U.S.C. §3124(a)." (App., p. 29a). Accordingly, on December 13, 1985, the Tax Court ordered the State to grant the claimed refund (App., p. 26a).

The State appealed the decision of the Maryland Tax Court to the Circuit Court for Baltimore City. In its Memorandum of Appellee, the Bank raised each of the questions presented in this appeal. On October 2, 1986, the Circuit Court affirmed the decision of the Maryland Tax Court. It held that the plain wording of 12 U.S.C. §1433 prohibited Maryland from including interest earned on FHLB bonds in the

measure of the franchise tax (App., p. 15a). The Circuit Court also rejected the State's argument that the inclusion of interest earned on FHLB bonds was permitted by 31 U.S.C. §3124(a). The Circuit Court held that §3124(a) was inapplicable because FHLB bonds were not obligations of the United States (App., p. 17a). Alternatively, the Court held that, even if the bonds were viewed as obligations of the United States, the specific prohibition against state taxation of FHLB bonds in 12 U.S.C. §1433 was controlling over the general provisions in 31 U.S.C. §3124(a) (App., pp. 17a-18a).

The State appealed the judgment of the Circuit Court to the Court of Special Appeals of Maryland. Prior to consideration by that Court, the Court of Appeals of Maryland issued a writ of certiorari on its own motion. On review by the Court of Appeals, the Bank raised in its brief each of the questions here presented.

On October 6, 1987, the Court of Appeals reversed the judgment of the Circuit Court (App., pp. 1a-13a). It held that the inclusion of FHLB bonds in the measure of the Maryland franchise tax did not violate 12 U.S.C. §1433 because §1433 did not prohibit the inclusion of interest earned on FHLB bonds in the measure of a state franchise tax (App., p. 8a). Despite the text of 12 U.S.C. §1435 to the contrary, the Court of Appeals also decided that FHLB bonds were obligations of the United States under 31 U.S.C. §3124(a). (App., p. 12a). It proceeded to hold that §3124(a) permits interest earned on FHLB bonds to be included in the measure of a state franchise tax.

THE QUESTIONS ARE SUBSTANTIAL

The questions presented in this appeal are substantial and merit plenary consideration. The question of whether 12 U.S.C.§1433 prohibits the inclusion of interest earned on FHLB bonds in the measure of a state franchise tax is important due to the significant number of obligations issued by the FHLB, and the fact that numerous states have taken the position that they are permitted to impose franchise taxes measured by such obligations.[3]

Whether or not FHLB bonds constitute "obligations of the United States" is also important. That question involves the precise scope of the term "obligations of the United States." The decision of the Court of Appeals of Maryland is inconsistent with this Court's definition of such obligations in *Smith v. Davis*, 323 U.S. 111 (1944), as reaffirmed in *Rockford Life Ins. Co. v. Illinois Dept. of Revenue*, ___ U.S. ___ , 107 S. Ct. 2312 (1987). The Court of Appeals' decision also stands in sharp conflict with two other recent decisions regarding the meaning of "obligations of the United States" under 31 U.S.C. §3124(a). *Protest of First Federal Savings & Loan Association*, 743 P.2d 640 148 (Okla. 1987); *Farmers & Traders State Bank v. Johnson*, 121 Ill. App. 3d 43, 458 N.E.2d 1365 (1984).

The issue of whether a specific exemption statute (such as 12 U.S.C. §1433) provides a broader exemp-

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[3] This Court considered a different part of 12 U.S.C. §1433 in *Laurens Fed'l Savings & Loan Ass'n. v. South Carolina Tax Comm'n.*, 365 U.S. 517 (1961). That case involved the second sentence of §1433 relating to taxation of advances made by the Federal Home Loan Bank, and did not consider the first sentence of §1433 exempting any and all FHLB bonds from all state taxation.

tion from state taxation than the general provision in 31 U.S.C. §3124(a), was specifically left open by this Court in *Memphis Bank & Trust Co. v. Garner*, 459 U.S. 392, 396 n.5 (1983). The importance of the question is highlighted by the design of Congress, in 12 U.S.C. §1433 and other statutes, to exempt certain bonds otherwise subject to state franchise taxes under the permissive clause of 31 U.S.C. §3124(a)(1).

1. The Maryland Statute Requiring Interest Earned on Federal Home Loan Bank Bonds to be Included in Measuring the Maryland Franchise Tax Violates 12 U.S.C. §1433, Exempting Such Bonds Both as to Principal and Interest From All State Taxation (Except Surtaxes, Estate, Inheritance, and Gift Taxes), and is Therefore Invalid Under the Supremacy Clause.

The plain language of 12 U.S.C. §1433 prohibits Maryland from including interest earned on FHLB bonds in the measure of its franchise tax. The first sentence of §1433 provides: "Any and all notes, debentures, bonds, and other such obligations issued by any bank, and consolidated Federal Home Loan Bank bonds and debentures, shall be exempt both as to principal and interest from all taxation (except surtaxes, estate, inheritance, and gift taxes) now or hereafter imposed by the United States or by any State, county, municipality or local taxing authority." The plain language of §1433 leaves no room for state taxation of interest earned on FHLB bonds by requiring such interest to be included in the net earnings subject to a franchise tax. This Court has repeatedly held that courts must give effect to "plain and unambig-

uous" statutory language, *United States v. Rutherford*, 442 U.S. 544, 551-52 (1979), and that it "cannot justify disregard of what Congress has plainly and intentionally provided." *C.I.R. v. Asphalt Products Co.*, ___ U.S. ___, 107 S. Ct. 2275, 2278 (1987).

In enacting §1433, Congress sought to exempt FHLB bonds "from all taxation (except surtaxes, estate, inheritance, and gift taxes) now or hereafter imposed * * * by any State * * *." Franchise taxes were conspicuously omitted from the statutory list of exceptions, which reinforces the conclusion that states may not require interest earned on FHLB bonds to be considered in the measure of a franchise tax. If Congress intended to permit state franchise taxes on interest earned on FHLB bonds, it easily could have added franchise taxes to the list of permitted state taxes. That Congress did not create an exception for franchise taxes is very significant: "Where Congress explicitly enumerates certain exceptions to a general prohibition, additional exceptions are not to be implied, in the absence of evidence of a contrary legislative intent." *Andrus v. Glover Construction Co.*, 446 U.S. 608, 616-17 (1980). *See United States v. Rutherford, supra*, 442 U.S. at 552.

When Congress provides a blanket exemption from state taxation subject only to enumerated exceptions, as it did in enacting 12 U.S.C. §1433, courts are not at liberty to imply other exceptions. In 1959, for example, Congress amended 31 U.S.C. §742 (now 31 U.S.C. §3124(a)) so as to exempt from state taxation "all" obligations of the United States, "except nondiscriminatory franchise or other nonproperty taxes in lieu thereof imposed on corporations and except estate taxes or inheritance taxes." No provision was

made for bank shares taxes, another form of indirect taxation. In *American Bank & Trust Co. v. Dallas County*, 463 U.S. 855 (1983), this Court disallowed an attempt by Texas to impose a tax on bank shares without deducting the value of federal obligations held by the banks. This Court viewed the specific enumeration as "inconsistent with implied exceptions" and concluded: "From the specific exceptions for franchise and estate taxes and inheritance taxes, and the conspicuous omission of shares taxes from that group, only one inference is possible: Congress meant to bar shares taxes to the extent they consider federal obligations in the computation of the tax." *Id.* at 864.

The same analysis should be applied to §1433. From the specific exemption for "surtaxes, estate, inheritance, and gift taxes," and the conspicuous omission of franchise taxes, the only permissible inference is that Congress intended to prohibit state franchise taxes to the extent they consider interest earned on FHLB bonds in computing the franchise tax.

In *American Bank*, this Court found it conspicuous that state shares taxes had been omitted from the list of permissible state taxes in §742. Historically, this Court had upheld the inclusion of interest on federal obligations in the measure of state bank shares taxes, inheritance taxes and franchise taxes, under the theory that such taxes were not imposed directly on federal obligations. Accordingly, when 31 U.S.C. §742 prohibited all state taxation except franchise, estate and inheritance taxes, this Court noted in *American Bank* that the failure to create a further exception for state shares taxes reflected a congressional intent not to permit such taxes. 463 U.S. at 864.

This identical analysis applies here. Prior to the enactment of 12 U.S.C. §1433, this Court had held that states could impose indirect privilege taxes (such as franchise, estate, and inheritance taxes), and measure the value of the privilege by considering interest on federal obligations. *See, e.g., Educational Films Corp. v. Ward*, 282 U.S. 379 (1931) (franchise tax); *Plummer v. Coler*, 178 U.S. 115 (1900) (inheritance tax). In light of the fact that state franchise, estate, inheritance and gift taxes were grouped together as indirect privilege taxes, the specific exception in §1433 for estate, inheritance and gift taxes, coupled with the conspicuous failure to make exception for franchise taxes, reflected a congressional intent not to permit the latter.

The Court of Appeals of Maryland declined to apply the *American Bank* analysis. It thought that the Texas bank shares tax, in contrast to the Maryland franchise tax, "was a property tax imposed directly on the federal obligations held by the taxpayer and consequently violated the immunity defined in 31 U.S.C. §3124(a)." (App., p. 8a). However, in *American Bank*, this Court specifically noted that bank shares taxes, like franchise, estate, and inheritance taxes, had been upheld in years past because they were not imposed directly on the ownership of federal obligations. 463 U.S. at 863-64. Indeed, *American Bank* proceeded in full recognition that the Texas shares tax "indirectly" took into account federal obligations in computing the tax, *Id.* at 863, but disallowed it because that form of tax was not included in the list of exceptions permitted by 31 U.S.C. §742. Similarly, the franchise tax imposed by Maryland in this case is prohibited by 12

U.S.C. §1433 because it is not among the group of indirect taxes permitted by §1433.

The Court of Appeals also held that §1433's broad exemption from state taxation was not offended because the Maryland franchise tax does not tax the bonds, or interest on them, but rather the privilege of doing business in corporate form (App., p. 8a). The Court of Appeals relied upon numerous decisions of this Court, including *Werner Machine Co. v. Director of Div. of Taxation*, 350 U.S. 492 (1956), which held that franchise and other indirect taxes can be measured by interest earned on otherwise exempt federal obligations. However, this Court has never addressed the permissability of an indirect state tax when Congress has expressly provided an exemption for certain indirect state taxes, but not the tax in question. No prior case in this Court controls the disposition of this case. In 12 U.S.C. §1433, Congress has plainly provided that "any and all" FHLB bonds are exempt from "all taxation" except as authorized therein. Unlike the statutes previously addressed by this Court, the prohibition of "all taxation" in §1433 must be construed to prohibit privilege taxes unauthorized by Congress, such as the Maryland franchise tax. In enacting §1433, Congress must have believed that indirect taxes, such as estate, inheritance and gift taxes, were included within the immunity of FHLB bonds from "all taxation"; "otherwise, the specific exemptions for these taxes would have been superfluous." *American Bank*, 463 U.S. at 864.

The only response by the Court of Appeals of Maryland was that the canon against treating statutory language "as surplusage is not an immutable physical law of the universe * * *." (App., p. 9a). Neverthe-

less, it is an elementary rule of law accepted and frequently applied by this Court. *See, e.g., American Bank*, 463 U.S. at 864; *Colautti v. Franklin*, 439 U.S. 379, 392 (1979); *Weinberger v. Hynson, Westcott and Dunning, Inc.*, 412 U.S. 609, 633 (1973).

The Court of Appeals of Maryland assumed that the purpose of Congress in enacting 12 U.S.C. §1433 was to perpetuate "the direct tax-indirect measurement distinction which shone more brightly in 1932, when §1433 was enacted, than it does today." (App., p. 7a). However, if Congress did entertain such a purpose, the Court of Appeals did not explain why Congress provided expressly in §1433 that certain "indirect measurement" taxes would be permitted, but made no provision for franchise taxes.

Finally, *American Bank* teaches that, unless there is "a clearly expressed legislative intention to the contrary, [the statutory] language must ordinarily be regarded as conclusive." 463 U.S. at 862. In §1433 there was no clearly expressed intent of Congress to expose interest earned on FHLB bonds to state franchise taxes measured by net earnings. Indeed, the intent of Congress to prohibit "all taxation" in any form is clearly manifested by the parenthetical of stated exceptions to that prohibition. "This Court has held that Congress in saying 'all' meant exactly what it said, and that * * * the burden is heavily on the suitor who would subject the word 'all' with its uncompromising generality to an unexpressed exception." *Baltimore Nat'l. Bank v. State Tax Commission of Maryland*, 297 U.S. 209, 212 (1936).

The legislative history supports these conclusions. When the Federal Home Loan Bank Act was first brought to full House Committee, the bill exempted

FHLB bonds from every form of state taxation. Following objections from some members of Congress, the Committee ultimately agreed to amend the bill so as to subject FHLB bonds to surtaxes, estate, inheritance and gift taxes. (75 Cong. Rec. 12,590-91; 13,108 (1932)). When the bill reached the floor, the House specifically rejected a further amendment which would have permitted the states to impose additional taxes on FHLB bonds (75 Cong. Rec. 13,108). In short, the legislative history indicates that Congress meant what it said in enacting its final version of §1433.[4]

In light of the clear mandate of §1433 that interest income earned on FHLB bonds is not subject to state taxation, to the extent that Md. Ann. Code, art. 81, §128A(b) authorizes taxation of such income, it is invalid under the Supremacy Clause. *McCulloch v. Maryland*, 4 Wheat. 316 (1819). *See Society for Savings in the City of Cleveland v. Bowers*, 349 U.S. 143, 144 (1955). Congress having exempted FHLB bonds from "all taxation", §1433 has been identified by this Court as an act of Congress "explicitly preempting" state law.

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[4] The Court of Appeals cited several opinions issued in 1975 and 1976 by the Federal Home Loan Bank Board concluding that stock dividends of the Federal Home Loan Bank were subject to state franchise taxes (App., pp. 12a-13a). However, those opinions were issued under a different part of §1433 and did not purport to address the statutory language at issue in this case. The Court of Appeals concluded that the provision in §1433 relating to the taxation of FHLB bonds should be interpreted in the same manner as the provision relating to taxation of dividends on stock of the Federal Home Loan Bank (App., p. 13a). However, the Court of Appeals offered no explanation for this conclusion, which disregards the fact that the statutory language in §1433 regarding these two investments is entirely different and serves different purposes.

Fidelity Federal Savings & Loan Ass'n v. de la Cuesta, 458 U.S. 141, 162 and n.15 (1982).

2. Federal Home Loan Bank Bonds Are Not "Obligations of the United States Government" Under 31 U.S.C. §3124(a) Because Congress Expressly Provided in 12 U.S.C. §1435 That Such Bonds Are "Not Obligations of the United States" and Because Such Bonds Are Not Backed by the Full Faith and Credit of the United States.

The Court of Appeals of Maryland treated FHLB bonds as "obligations of the United States Government" under 31 U.S.C. §3124(a). By so regarding the bonds, the Court was able to hold the bonds subject to state taxation under the exception for "a nondiscriminatory franchise tax" provided by §3124(a)(1). (App., p. 8a). This holding is inconsistent with 12 U.S.C. §1435 and prior decisions of this Court. It also conflicts with decisions in two other jurisdictions. See *Protest of First Federal Savings & Loan Ass'n*, 743 P.2d 640 (Okla. 1987); *Farmers & Traders State Bank v. Johnson*, 121 Ill. App. 3d 43, 458 N.E.2d 1365 (1984).

FHLB bonds demonstrably are not obligations of the United States. Congress expressly provided in 12 U.S.C. §1435 that "all obligations of Federal Home Loan Banks shall plainly state that such obligations are not obligations of the United States and are not guaranteed by the United States." The legislative history of §1435 indicates that Congress was concerned that investors might be misled into believing that FHLB bonds were government obligations, or believing that the United States Government would be li-

able for the bonds. The original bill did not contain the quoted disclaimer. It was added during floor debate. By enacting §1435 with the disclaimer, Congress wanted to make it "perfectly clear that the bonds are not Government obligations." (75 Cong. Rec. 14,581 (1932)).

The decision below that FHLB bonds are obligations of the United States directly conflicts with prior decisions of this Court. In *Smith v. Davis*, 323 U.S. 111 (1944), this Court indicated that "obligations of the United States" under former 31 U.S.C. §742 applied to obligations authorized by Congress, which "pledged the faith and credit of the United States in support of the promise to pay." 323 U.S. at 115. This holding was reaffirmed last term in *Rockford Life Ins. Co. v. Illinois Dept. of Revenue*, ___ U.S. ___, 107 S. Ct. 2312 (1987), which held that obligations guaranteed by the Government National Mortgage Association (although backed by the full faith and credit of the United States) were not obligations of the United States under 31 U.S.C. §3124(a) because there was no binding promise by the United States to pay specified sums on specified dates. ___ U.S. at ___ , 107 S. Ct. at 2316.

The FHLB bonds in question are not backed by the full faith and credit of the United States and do not create a binding promise by the United States to pay specified sums on specified dates. Therefore, in view of the disclaimer in §1435, FHLB bonds do not constitute "obligations of the United States."[5] In fact,

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[5] In *Bankers Farm Mortgage Co. v. United States*, 69 F.Supp. 197 (Ct. Cl. 1947), *cert. denied*, 331 U.S. 831 (1947) the court held that Joint Stock Land Bank bonds were not obligations of

the Federal Home Loan Banks which issue the bonds are owned entirely by members of the Banks (generally savings and loan institutions), and not by the Government. *Association of Data Processing Service Organizations, Inc. v. Federal Home Loan Bank Board*, 568 F.2d 478, 480 (6th Cir. 1977). The Court of Appeals of Maryland recognized that FHLB bonds "do not carry the full faith and credit of the United States" (App., p. 10a), but failed to apply (or even refer to) the holdings of this Court in *Smith* and *Rockford*.

In *Memphis Bank & Trust Co. v. Garner*, 459 U.S. 392 (1983), this Court held that a Tennessee tax on the net earnings of banks was discriminatory because it defined net earnings to include interest on federal obligations, but not Tennessee obligations. This Court concluded that the tax on federal obligations was not permitted under former 31 U.S.C. §742 because the tax was not a "nondiscriminatory" franchise tax. This

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the United States. In *Bankers*, the owner of bonds issued by a defaulting bank sought to hold the United States liable for payment of the bonds. The bondholder argued that because Congress had provided expressly that the banks were instrumentalities of the Government of the United States, the bonds were exempt from federal and state taxation. However, the court held that the bonds were not obligations of the United States because Congress did not provide a promise to pay by the United States Government. The court therefore concluded that the declaration by Congress that "farm loan bonds issued under the Act 'shall be deemed and held to be instrumentalities of the Government of the United States' did not necessarily make the bonds governmental obligations." 69 F.Supp. at 205. Similarly, Congress did not provide that the Government would be liable for FHLB bonds, but expressly provided in §1435 that such bonds are not obligations of the United States and are not guaranteed by the United States.

Court noted that the exemption in §742 applied "also to the obligations of such instrumentalities of the United States as Federal Farm Credit Banks." 459 U.S. at 396.

However, in establishing the Federal Farm Credit Banks, Congress did not provide—as it did in enacting §1433—that obligations of these banks were "not obligations of the United States." Thus, *Memphis Bank* cannot be read as a holding that bonds issued by instrumentalities created by Congress invariably constitute obligations of the United States—even when Congress expressly provides to the contrary. Although the prior cases of this Court, for purposes of 31 U.S.C. §3124(a) immunity, have drawn no distinction between obligations of the United States and the obligations of federal credit banks, *Id.*, 459 U.S. at 396 n.5, the enactment of 12 U.S.C. §1435 compels such a distinction in regard to the status of FHLB bonds.

The failure of the Court of Appeals of Maryland to give effect to the disclaimer in §1435 is completely at odds with a simultaneous decision by the Supreme Court of Oklahoma. In *Protest of First Federal Savings & Loan Ass'n*, 743 P.2d 640 (Okla. 1987), it was urged that bonds issued by the Federal National Mortgage Association (FNMA) were "obligations of the United States" and thus exempt from state tax under 31 U.S.C. §3124(a). The argument was rejected and *Memphis Bank* was distinguished on the ground that the authorizing statute "specifically mandates that the bonds issued by FNMA are not obligations of the United States." *First Federal*, 743 P.2d at 646.

The Appellate Court of Illinois has drawn the same conclusion that FNMA bonds are not "obligations of

the United States" under former 31 U.S.C. §742. *Farmers & Traders State Bank v. Johnson, supra.* The court noted that Congress, in authorizing FNMA bonds, provided that such obligations did not constitute obligations of the United States. Moreover, the court held that FNMA bonds did not have the characteristics of obligations of the United States as defined in *Smith v. Davis, supra.* FNMA bonds did not have congressional authorization pledging the full faith and credit of the United States in support of the promise to pay. *Farmers & Traders*, 458 N.E.2d at 1369. Thus, FNMA bonds were held not to constitute obligations of the United States.

Other jurisdictions, such as the District of Columbia, have also interpreted the exemption in 31 U.S.C. §3124(a) for obligations of the United States to apply only to bonds for which Congress has pledged the full faith and credit of the United States. (D.C. Regs. tit. x, §100.7 (1982)). This Court should therefore note probable jurisdiction to resolve the conflict regarding the types of obligations that are subject to 31 U.S.C. §3124(a).

3. Assuming That 31 U.S.C. §3124(a) Applies At All, The Exemption Provided by 12 U.S.C. §1433 of Federal Home Loan Bank Bonds From All State Taxation (Except Surtaxes, Estate, Inheritance, and Gift Taxes) is Broader Than the Exemption Provided in 31 U.S.C. §3124(a) Allowing Nondiscriminatory Franchise Taxes on Obligations of the United States.

This case presents the issue left open in *Memphis Bank, supra.* In *Memphis* this Court held that a Ten-

nessee tax was impermissible under former 31 U.S.C. §742 because it discriminated against federal obligations. Therefore, there was no occasion for this Court to address Memphis Bank's further question whether, assuming the tax was permitted under §742 as a "nondiscriminatory franchise tax", Congress had provided a broader immunity than §742 by enacting specific legislation conferring tax-exempt status upon obligations of the Federal Farm Credit Banks. This Court reserved that question:

> In establishing the Federal Farm Credit Banks, Congress made clear that the obligations of these banks would be immune from taxation by the States. 12 U.S.C. §§2055, 2079 and 2134. We have no occasion to determine whether the immunity described in these provisions is broader than that otherwise provided by 31 U.S.C. §742 * * *.

Memphis Bank, 459 U.S. at 396 n.5.

The question left unresolved in *Memphis Bank* is squarely presented in this very case. Assuming that FHLB bonds are held to be obligations of the United States, the immunity described in §1433 for FHLB bonds is broader than that otherwise provided by 31 U.S.C. §3124(a). This is a very important federal question because it involves the continued viability of various tax exemption statutes enacted periodically by Congress which employ language significantly different than that contained in 31 U.S.C. §3124(a). It calls into question the very necessity for Congress to legislate, separately and apart from §3124(a), the tax exempt status of a variety of specific obligations.

The Court of Appeals of Maryland held that 12 U.S.C. §1433 and 31 U.S.C. §3124(a) would create an irreconcilable conflict unless §1433 was interpreted to be inapplicable to franchise taxes (App., pp. 6a-7a). However, there is no irreconcilable conflict between those provisions. The fact that "a nondiscriminatory franchise tax" may be imposed under §3124(a)(1) upon the obligations of the United States in general, with the consent of Congress, is not inconsistent with the intent of Congress in §1433 to protect FHLB bonds in particular from that form of tax by its exemption from "all taxation" of those particular bonds. Indeed, because corporate and bank purchasers of FHLB bonds form the primary market for such obligations, Congress undoubtedly identified state franchise taxes on corporate and bank earnings as a major impediment to marketability.

Certainly, there is nothing in §3124(a)(1) to suggest an implied repeal of §1433 and its comprehensive grant of immunity from "all taxation" except as therein provided.[6] In *American Bank & Trust Com-*

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[6] In 1987, while enacting the Federal Savings and Loan Insurance Corporation Recapitalization Act of 1987, Congress established the Financing Corporation and mandated that the tax-exempt provisions of 12 U.S.C. §1433 would govern obligations of the new instrumentality: "(A) In General—Except as provided in subparagraph (B), obligations of the Financing Corporation shall be exempt from tax both as to principal and interest to the same extent as any obligation of a Federal Home Loan Bank is exempt from tax under section 13." Competitive Equality Banking Act of 1987, Pub. L. No. 100-86, 101 Stat. 552, 591, tit. III, §302, codified as 12 U.S.C. §1441(e)(8)(A). By its 1987 reaffirmation of 12 U.S.C. §1433, Congress neither intended "to resurrect the formalistic approach" of pre-1959 cases, *American Bank*, 463 U.S. at 867, nor chose to incorporate the franchise

pany v. Dallas County, supra, this Court engaged in similar analysis in rejecting a contention that a Texas bank shares tax that violated one federal statute nevertheless could be validly imposed on federal obligations merely because it did not violate another federal statute. 463 U.S. at 870-73. Thus, although Congress authorized state franchise taxes under §3124(a), that does not mean that Congress intended to ~~prohibit~~ repeal existing statutes prohibiting all such taxation of particular bonds, such as FHLB bonds covered by §1433.

In addition, it is apparent that §1433, which discusses the state taxation of FHLB bonds, is more specific than the general provision in 31 U.S.C. §3124(a) regarding obligations of the United States in general. It is well established that a more specific statute will be given precedence over a more general statute. *Busic v. United States*, 446 U.S. 408 (1980). Moreover, "[i]t is a basic principle of statutory construction that a statute dealing with a narrow, precise, and specific subject is not submerged by a later enacted statute covering a more generalized spectrum." *Radzanower v. Touche Ross & Co.*, 426 U.S. 148, 153 (1976).

CONCLUSION

For these reasons, this Court should note probable jurisdiction of this appeal.

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tax exception of 31 U.S.C. §3124(a)(1) when it immunized obligations of the Financing Corporation to the same extent as FHLB bonds.

Respectfully Submitted,

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APPENDIX

IN THE COURT OF APPEALS OF MARYLAND

No. 6

September Term, 1987

STATE DEPARTMENT OF
ASSESSMENTS AND TAXATION

v.

MARYLAND NATIONAL BANK

MURPHY, C.J.
ELDRIDGE
COLE
RODOWSKY
*COUCH
MCAULIFFE
ADKINS,
JJ.

Opinion by Rodowsky

Filed: October 6, 1987

This case presents a question of interpretation of congressional statutes which were intended to minimize problems in applying the doctrine of intergovernmental immunity in the taxation context. The problem of intergovernmental immunity at hand arises from Maryland's having included in the measurement of the franchise tax imposed on the appellee, Maryland National Bank (the

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* Couch, J., now retired, participated in the hearing and conference of this case while an active member of this Court; after being recalled pursuant to the Constitution, Art. 31, Sec. 3A, he also participated in the decision and adoption of this opinion.

Bank), interest earned by the Bank on certain bonds issued by an instrumentality of the United States. The problem of interpretation arises because there are different federal statutes on which the adversaries rely to support their respective positions.

Maryland imposes a franchise tax on domestic financial institutions for the privilege of existing as a corporation and on foreign financial institutions for the privilege of transacting business in this state in corporate form. Md. Code (1957, 1980 Repl. Vol., 1986 Cum. Supp.), Art. 81, § 128A(a). The tax is measured by net earnings. § 128A(b). The Bank is a corporation organized and existing under the National Bank Act. For purposes of state taxation it is to "be treated as a bank organized and existing under the laws of the State or other jurisdiction within which its principal office is located." 12 U.S.C. § 548 (1982). The Bank's principal office is in Maryland and the Bank is subject to the franchise tax on financial institutions.

There is no contention in this case that the Maryland tax is other than a true franchise or privilege tax. Nor is there any contention that the tax applies or is administered in a discriminatory fashion.

For the years 1979 through 1982 the Bank included in its report of net earnings subject to the franchise tax a total of $2,818,727.79 of interest on consolidated bonds of Federal Home Loan Banks (FHLB). It paid the tax under protest and then claimed a refund.

The State Department of Assessments and Taxation (the State) denied the refund and, on the Bank's appeal, the Maryland Tax Court ordered the refund to be made. The Circuit Court for Baltimore City affirmed the order of the Tax Court and we issued the writ of certiorari on our own motion prior to consideration of the State's appeal by the Court of Special Appeals.

The Bank relies principally on § 13, as amended, of the Federal Home Loan Bank Act of July 22, 1932, ch. 522,

§ 13, 47 Stat. 735, now codified as 12 U.S.C. § 1433. Section 1433 reads as follows:

> Any and all notes, debentures, bonds, and other such obligations issued by any bank, and consolidated Federal Home Loan Bank bonds and debentures, shall be exempt both as to principal and interest from all taxation (except surtaxes, estate, inheritance, and gift taxes) now or hereafter imposed by the United States, by any Territory, dependency, or possession thereof, or by any State, county, municipality, or local taxing authority. The bank, including its franchise, its capital, reserves, and surplus, its advances, and its income, shall be exempt from all taxation now or hereafter imposed by the United States, by any Territory, dependency, or possession thereof, or by any State, county, municipality, or local taxing authority; except that . . . any real property of the bank shall be subject to State, Territorial, county, municipal, or local taxation to the same extent according to its value as other real property is taxed. The notes, debentures, and bonds issued by any bank, with unearned coupons attached, shall be accepted at par by such bank in payment of or as a credit against the obligation of any homeowner debtor of such bank.[1]

The State submits that, when interpreted in the light of history, § 1433 has no application to a franchise tax and that the controlling statute is 31 U.S.C. § 3124(a) (1982). The latter provides:

> Stocks and obligations of the United States Government are exempt from taxation by a State or

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[1] The language "and consolidated Federal Home Loan Bank bonds and debentures" was added by the Act of May 28, 1935, ch. 150, § 8, 49 Stat. 295. The bonds involved in the instant case are consolidated bonds.

> political subdivision of a State. The exemption applies to each form of taxation that would require the obligation, the interest on the obligation, or both, to be considered in computing a tax, except—
>
> (1) a nondiscriminatory franchise tax or another nonproperty tax instead of a franchise tax, imposed on a corporation; and
>
> (2) an estate or inheritance tax.

The State has analyzed the problem correctly, in our view.

The doctrine of intergovernmental immunity rests on the nature of the federal system created by the United States Constitution. With particular respect to a prohibition against state taxation of the obligations of federal instrumentalities, the doctrine has been recognized since *M'Culloch v. Maryland*, 4 Wheat. 316, 4 L. Ed. 579 (1819). In connection with the issuance of treasury notes to finance the Civil War and to prevent their possible taxation by the states, Congress undertook to express the constitutional prohibition in a statute. P. Hartman, *Federal Limitations on State and Local Taxation*, § 6:20, at 340 (1981) (Hartman). That enactment essentially became Rev. Stat. § 3701 and, later, 31 U.S.C. § 742 (1952), which read:

> Except as otherwise provided by law, all stocks, bonds, Treasury notes, and other obligations of the United States, shall be exempt from taxation by or under State or municipal or local authority.

In 1865 the Supreme Court struck down the application of a New York property tax to obligations of the United States owned by a bank, saying that "the tax is imposed on the property of the institutions, as contradistinguished from a tax upon their privileges or franchises." *The Bank Tax Case*, 2 Wall. 200, 209, 17 L. Ed. 793, 795 (1865). There followed a line of cases in the Supreme Court, decided while the substance of 31 U.S.C. § 742 was in effect,

sustaining privilege taxes measured by nontaxable federal securities. The judicial rationale was "that the taxing State has power to impose the tax on a privilege, which it had power to withhold; and which, therefore, the State has the power to tax. . . . [W]hen the State is imposing a tax on its own creation, it is not interfering with the operations of the Federal Government." Hartman, *supra*, at 348 (footnote omitted).

Writing in 1956 in *Werner Machine Co. v. Director of Div. of Taxation*, 350 U.S. 492, 494, 76 S. Ct. 534, 535, 100 L. Ed. 634, 637, the Supreme Court said in a per curiam opinion that it "has consistently upheld franchise taxes measured by a yardstick which includes tax-exempt income or property, even though a part of the economic impact of the tax may be said to bear indirectly upon such income or property." The Court then cited, in chronological order, *Society for Sav. v. Coite*, 6 Wall. 594, 18 L. Ed. 897 (1868); *Provident Inst. for Sav. v. Massachusetts*, 6 Wall. 611, 18 L. Ed. 907 (1868); *Hamilton Co. v. Massachusetts*, 6 Wall. 632, 18 L. Ed. 904 (1868); *Home Ins. Co. v. New York*, 134 U.S. 594, 10 S. Ct. 593, 33 L. Ed. 1025 (1890); *Educational Films Corp. of America v. Ward*, 282 U.S. 379, 51 S. Ct. 170, 75 L. Ed. 400 (1931); and *Pacific Co. v. Johnson*, 285 U.S. 480, 52 S. Ct. 424, 76 L. Ed. 893 (1932).

In *Educational Films, supra*, decided in the year before enactment of the Home Loan Bank Act of 1932, the Court stated:

> [W]e cannot say that the rule applied by this court for some seventy years, that a nondiscriminatory tax upon corporate franchises is valid, notwithstanding the inclusion of tax exempt property or income in the measure of it, has failed of its purpose, or has worked so badly as to require a departure from it now; or that the present tax, viewed in the light of actualities, imposes

> any such real or direct burden on the federal government as to call for the application of a different rule. [282 U.S. at 392.]

Present 31 U.S.C. § 3124(a) was enacted in 1959.[2] The 1959 enactment was a response to an Idaho statute which imposed a tax upon individuals measured by an individual's net income. Idaho took the position that the tax need not exempt interest received on federal obligations. The 1959

> amendment plainly did more than make clear that the interest on federal obligations was tax exempt. Idaho relied on the formal distinction between a tax on an individual, measured by his net income, and a tax on income itself. . . . To answer this argument, the amendment abolished the formalistic inquiry whether the tax is *on* a distinct interest, and replaced it with the inquiry whether "computation of the tax" requires consideration of federal obligations. [*American Bank & Trust Co. v. Dallas County*, 463 U.S. 855, 867, 103 S. Ct. 3369, 3377, 77 L. Ed. 2d 1072, 1082 (1983) (citation omitted).]

The Bank submits that 12 U.S.C. § 1433, which authorizes FHLB bonds, is more specific as to FHLB bonds than 31 U.S.C. § 3124(a), that § 1433 declares an exemption from "all" taxation, and that the omission of franchise taxation from the specifically enumerated exceptions to the grant of exemption demonstrates congressional intent for FHLB bonds to be exempt from state franchise taxes "both as to principal and interest." If we assume that FHLB bonds are "obligations of the United States Government" within the meaning of 31 U.S.C. § 3124(a) (see discussion, *infra*), then the Bank's interpretation of 12 U.S.C. § 1433 places it in irreconcilable conflict with 31 U.S.C. § 3124(a)

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[2] Pub. L. 86-346, of September 22, 1959, § 105(a), 73 Stat. 622. The statute was previously codified as 31 U.S.C. § 742.

insofar as nondiscriminatory franchise taxes are concerned. The rules of statutory construction applied by the Supreme Court to federal statutes are not significantly different from those which we apply. In *Watt v. Alaska*, 451 U.S. 259, 266-67, 101 S. Ct. 1673, 1678, 68 L. Ed. 2d 80, 88 (1981), Justice Powell said for the Court:

> Sole reliance on the "plain language" of § 401(a) would assume the answer to the question at issue. These cases involve two statutes, each of which by its literal terms applies to the facts before us. Restatement of the terms of § 401(a) cannot answer which statute Congress intended to control. Recognizing this, the Secretary invokes the maxim of construction that the more recent of two irreconcilably conflicting statutes governs. 2A C. Sands, Sutherland on Statutes and Statutory Construction § 51.02 (4th ed. 1973). Without depreciating this general rule, we decline to read the statutes as being in irreconcilable conflict without seeking to ascertain the actual intent of Congress. Our examination of the legislative history is guided by another maxim: " 'repeals by implication are not favored,' " . . . . "The intention of the legislature to repeal must be 'clear and manifest.' " . . . We must read the statutes to give effect to each if we can do so while preserving their sense and purpose. [Citations omitted.]

In the case before us the two statutes can be read compatably by reading 12 U.S.C. § 1433 in the light of the direct tax-indirect measurement distinction which shone more brightly in 1932, when § 1433 was enacted, than it does today. The Maryland franchise tax does not offend § 1433's command that "all [FHLB] bonds, and other such obligations . . . shall be exempt both as to principal and interest from all taxation (except surtaxes, estate, inheritance, and gift taxes) now or hereafter imposed by . . .

any State" because Maryland has not taxed the bonds or the interest on them. Maryland has taxed the privilege of doing business as a financial institution in corporate form in this state and has measured the tax by net income which constitutionally may, under the principle established by the intergovernmental immunity cases cited above, include interest on federal obligations. Thus, the exemption first created in 1932 for FHLB bonds and interest does not control here because the Maryland franchise tax does not tax interest on the FHLB bonds. Title 31, § 3124(a) later abolished the long-standing legal distinction in the intergovernmental immunity context between direct tax and indirect measurement, but the abolition was accompanied by an express federal consent to using interest on federal obligations to compute a nondiscriminatory franchise tax.

American Bank & Trust Co. v. Dallas County, supra, relied upon by the Bank, is not to the contrary. The Court in that case invalidated a Texas tax on bank shares which included tax-exempt United States obligations in its computation. The Texas tax, however, was a property tax imposed directly on the federal obligations held by the Texas taxpayer and consequently violated the immunity defined in 31 U.S.C. § 3124(a).[3]

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[3] Memphis Bank & Trust Co. v. Garner, 459 U.S. 392, 103 S. Ct. 692, 74 L. Ed. 2d 562 (1983) held that a Tennessee excise tax on banks was invalid because it was discriminatory. The Court did not reach the question whether the Tennessee tax was a "franchise or another nonproperty tax" within the meaning of 31 U.S.C. § 3124(a)(1). 459 U.S. at 396 n.6.

Recent state court decisions have sustained measuring a true franchise tax by gross income which included the interest on federal obligations. Commissioner of Revenue v. Massachusetts Mutual Life Ins. Co., 384 Mass. 607, 428 N.E.2d 297 (1981); Reuben L. Anderson-Cherne, Inc. v. Comm'r of Taxation, 303 Minn. 124, 226 N.W.2d 611, appeal dismissed, 423 U.S. 886, 96 S. Ct. 181, 46 L. Ed. 2d 118 (1975); and Schwinden v. Burlington Northern, Inc., 691 P.2d 1351 (Mont. 1984), later proceeding, 730 P.2d 422 (Mont. 1986). In these cases the analysis

The Bank emphasizes in its argument that the reconciliation which we have approved above renders part of the first sentence of 12 U.S.C. § 1433 surplusage. The Bank's point is that an excise tax imposed on the transfer of the assets of a decedent to the decedent's legatees and measured by the value of the assets of the decedent's estate is not a direct tax on the estate assets. *See, e.g., United States v. United States Manufacturers National Bank*, 363 U.S. 194, 198, 80 S. Ct. 1103, 1106, 4 L. Ed. 2d 1158, 1162 (1960); *Greiner v. Lewellyn*, 258 U.S. 384, 387, 42 S. Ct. 324, 324, 66 L. Ed. 676, 677 (1922); *Plummer v. Coler*, 178 U.S. 115, 130, 20 S. Ct. 829, 835, 44 L. Ed. 998, 1006 (1900). The Bank correctly notes that, if the exemption for the principal and interest on FHLB bonds applies only to direct taxes, it was unnecessary for Congress parenthetically to except expressly from the exemption "estate, inheritance, and gift taxes[.]" The canon of construction which endeavors to give meaning to each word of a statute and to avoid construing any words as surplusage is not an immutable physical law of the universe, but is simply a guide to statutory construction. In the instant matter we are persuaded that Congress's purpose in enacting § 13 of the Homeowners Loan Act of 1932 is revealed by the seventy years of constitutional adjudication antedating the enactment, and not by an inflexible application of the no surplusage canon.

The Bank further submits that FHLB bonds are not "obligations of the United States Government" within the meaning of 31 U.S.C. § 3124(a) because 12 U.S.C. § 1435 provides in part that "[a]ll obligations of Federal Home Loan Banks shall plainly state that such obligations are not obligations of the United States and are not guaran-

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related to 31 U.S.C. § 3124(a) and its predecessor, rather than to the statute authorizing the federal securities, the income of which was included in the tax measurement.

teed by the United States."[4] This argument does not produce the result sought by the Bank. If the principal and interest of FHLB bonds are totally excluded from § 3124(a), then the exemption conferred by that section would not apply to FHLB bonds, including the extension of the exemption to the use of the federal security's income in computing the tax. The State then could still measure the franchise tax on the Bank's privilege by the income from those obligations, because the constitutional doctrine of intergovernmental immunity, as applied by the Supreme Court, does not prevent measuring a franchise tax by including income on federal obligations.

In any event the meaning of "obligation" in 12 U.S.C. § 1435 does not determine its meaning in 31 U.S.C. § 3124. Consolidated FHLB bonds are the joint and several obligations of all twelve Federal Home Loan Banks. G. Munn, *Encyclopedia* of Banking and Finance, at 333 (8th ed. 1983). Section 1435 alerts investors that the bonds do not carry the full faith and credit of the United States. In 31 U.S.C. § 3124(a) the obligations are those of the United States "Government" and include those of government agencies and instrumentalities.

The foregoing conclusion is supported by the federal income tax treatment of interest on federal obligations. 31 U.S.C. § 3124(b) provides:

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[4] Section 1435 reads in full:

Obligations of the Federal Home Loan Banks issued with the approval of the board under this chapter shall be lawful investments, and may be accepted as security, for all fiduciary, trust, and public funds the investment or deposit of which shall be under the authority or control of the United States or any officer or officers thereof. The Federal reserve banks are authorized to act as depositaries, custodians, and/or fiscal agents for Federal Home Loan Banks in the general performance of their powers under this chapter. All obligations of Federal Home Loan Banks shall plainly state that such obligations are not obligations of the United States and are not guaranteed by the United States.

> The tax status of interest on obligations and dividends, earnings, or other income from evidences of ownership issued by the Government or an agency and the tax treatment of gain and loss from the disposition of those obligations and evidences of ownership is decided under the Internal Revenue Code of 1954 (26 U.S.C. 1 et seq.). An obligation that the Federal Housing Administration had agreed, under a contract made before March 1, 1941, to issue at a future date, has the tax exemption privileges provided by the authorizing law at the time of the contract. This subsection does not apply to obligations and evidences of ownership issued by the District of Columbia, a territory or possession of the United States, or a department, agency, instrumentality, or political subdivision of the District, territory, or possession.

This statute is the Public Debt Act of February 19, 1941, ch. 7, § 4(a), 55 Stat. 9, with amendments which are not here material. Section 4(b) of the Act of February 19, 1941, further provided:

> The provisions of this section shall, with respect to such obligations, be considered as amendatory of and supplementory to the respective Acts or parts of Acts authorizing the issuance of such obligations, as amended, and supplemented.[5]

The instrumentalities of the United States which issued obligations carrying tax free interest prior to March 1, 1941, included the Federal Home Loan Banks. *See* P-H, *1987 Federal Income Taxes*, ¶ 8285(5). As a result of the

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[5] Section 4(a) of the Act of February 19, 1941, is no longer codified. It was Title 31, § 742a(b) in the 1940 (1941-1946 Supp.) and in the 1952 editions of the United States Code.

Public Debt Act of 1941, interest upon and gain from the sale or other disposition of FHLB bonds is subject to taxation as provided in the Internal Revenue Code. *See* 1 Moody's *Bank & Finance Manual*, 2916 (1987). The phrase, "obligations of the United States Government," as used in the Act of September 22, 1959, 31 U.S.C. § 3124(a) is at least as broad as "obligations . . . issued by the Government" as used in the Public Debt Act of 1941, 31 U.S.C. § 3124(b). Thus, § 3124(a) obligations include FHLB bonds.

Our analysis and interpretation of 12 U.S.C. § 1433 is shared by the Office of General Counsel of the Federal Home Loan Bank Board. In an opinion of October 29, 1975, the General Counsel had ruled that § 1433 rendered immune from inclusion in taxable income under an Arkansas tax dividends received by a federal savings and loan association on the capital stock it held in the Federal Home Loan Bank of Little Rock. In reliance on that opinion a federal association in Florida took the position that its dividend income on FHLB stock was not taxable by Florida. When the Florida tax collector pointed out that Florida's imposition was a franchise tax measured by net income, the savings and loan association turned to the FHLB Board. In an opinion of January 13, 1976, the General Counsel assumed that the Florida statute was "a valid franchise tax under Florida law" and, on that assumption, concurred in the conclusion of the Florida tax collector. After reviewing the Supreme Court cases which had "enunciated the distinction between a direct tax upon net income and an excise or franchise tax measured by net income," the General Counsel concluded:

> Since the tax immunity of Federal Home Loan Bank stock under § 13 of the Federal Home Loan Bank Act is no greater than that of the securities in *Tradesmens* [*National Bank of Oklahoma City v. Oklahoma Tax Comm'n*, 309 U.S. 560, 60 S. Ct. 688, 84 L. Ed. 947 (1940)] (Federal Reserve

> Bank stock) or *Werner* [*Machine Co. v. Dir., supra*, 350 U.S. 492] (United States Treasury bonds), in our view there appears to be no legal impediment to inclusion of Federal Home Loan Bank stock dividends in the income of savings and loan associations for the purpose of determining the franchise tax imposed by [the Florida statute].

Also on January 13, 1976, the Office of General Counsel rendered the same opinion to a federally chartered savings and loan association in Michigan because the Michigan "tax in question is more in the nature of a franchise tax for the privilege of doing business in the State than a direct tax on [the association's] income."

These opinions on behalf of the Federal Home Loan Bank Board likely concern the second sentence of § 1433 ("The bank, including its franchise, its capital, reserves, and surplus, its advances, and its income, shall be exempt from all taxation . . ."). Inasmuch as the second sentence of § 1433 is interpreted to recognize the judicial history of intergovernmental immunity, the first sentence of § 1433 should be interpreted in the same manner.

JUDGMENT OF THE CIRCUIT COURT FOR BALTIMORE CITY REVERSED. CASE REMANDED TO THAT COURT FOR THE ENTRY OF A JUDGMENT REVERSING THE ORDER OF THE MARYLAND TAX COURT AND REMANDING THIS CASE TO THE MARYLAND TAX COURT FOR THE ENTRY OF AN ORDER DENYING THE APPELLEE'S CLAIM FOR REFUND. COSTS TO BE PAID BY THE APPELLEE.

IN THE CIRCUIT COURT FOR BALTIMORE CITY

(ON APPEAL FROM MARYLAND TAX COURT MISC. 549)

STATE DEPARTMENT OF ASSESSMENTS AND TAXATION
Appellant

V.

MARYLAND NATIONAL BANK
Appellee

MARYLAND NATIONAL BANK
Cross Appellant

V.

STATE DEPARTMENT OF ASSESSMENTS AND TAXATION
Cross Appellee

MEMORANDUM OPINION AND ORDER

This court adopts the facts stipulated to in the Maryland Tax Court and in the "Statement of Facts" contained in the Maryland National Bank's (hereafter "MNB") Memorandum filed on June 19, 1986.[1] Since the facts are undisputed, the question is purely one of law. Therefore this court can determine whether the Tax Court made an error of law. *See,* Md. Code Ann. Art. 81, Sec. 229(o).

In this case the question is what was the intent of the legislature? The question presented is, should interest earned by the MNB on federal home loan bank bonds

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[1] This court does not consider, of course, the Attorney General's allegation that exemption from taxation will cost the State a lot of money. See Attorney General's Memorandum filed on May 7, 1986 at 2 and 3.

(FHLBBs) be included in "net earnings" for purposes of computing the Maryland franchise tax?[2]

"PLAIN MEANING"

12 U.S.C. Section 1433 (Sec. 1433) provides that interest on FHLBBs ". . . shall be exempt . . . from all tax (except surtaxes, inheritance and gift taxes) . . . by any state." This plain wording prohibits Maryland from taxing the interest earned on FHLBBs in net earnings for franchise tax purposes. Congress stated that it exempted interest on FHLBBs from *all* taxation except *surtaxes, estate, inheritance and gift taxes.* It did *not* except franchise taxes. Hence it did not *intend* to except franchise taxes. Many Maryland cases use a rule of statutory construction to support this interpretation, as for example, *Penna. Nat. Mut. Cas. Ins. Co.* v. *Gartelman,* 288 Md. 151, 156 (1980). The United States Supreme Court also applied this rule in the field of state taxation in *Amer. Bk. & Tr. Co.* v. *Dallas County,* 463 U.S. 855 (1983). The *American Bank* case held that if Congress creates numerous exceptions to a prohibition of state taxation, the only inference is that Congress intended to prohibit all other state taxation.[3]

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[2] Art. 81, Sec. 128A of the Annotated Code of Maryland. It is imposed on every domestic financial institution and is measured by the "net earnings" of such institutions, Sec. 128A(b). Net earnings are defined as "net income" as determined in accordance with Sec. 280A, with certain adjustments. Sec. 280A defines the net income of corporations for income tax purposes, and the franchise tax is imposed on this income, as adjusted, at the rate of 7%.

[3] The court was construing 31 U.S.C. Sec. 742, which provided that states could not tax federal obligations except for franchise, estate and inheritance taxes. It invalidated a Texas bank shares tax, stating:

> . . . From the specific exceptions for franchise and estate and inheritance taxes, and the conspicuous omission of shares taxes from that group, only one inference is possible: That Congress meant to bar shares taxes to the extent they consider federal obligations in the computations of the tax. *Amer. Bk.,* at 3375.

The state argues that Sec. 1433 does not explicitly bar franchise taxes and that the plain meaning rule is nothing more than an "inference from an omission." It depreciates the plain meaning inference which it says is "usually described" with the *expressio unius est exclusio alterius* doctrine.[4] It asserts that the plain meaning rule is only an aid to interpreting legislative intent and that the legislative intent of Sec. 1433, as shown by its legislative history and relation to other applicable federal statutes, shows that Congress did not intend that Sec. 1433 change the power of the states to impose franchise taxes.

However the logic and power of an inference has been well recognized by the courts, particularly in the field of state taxation, as for example, where there are exceptions to prohibitions of state taxation of federal obligations. *American Bank.* Moreover the absence of an exception for franchise taxes in Sec. 1433 (and the inclusion of an exception for estate tax and inheritance taxes) is especially conspicuous when it is considered that Congress and the courts have always grouped estate, inheritance and franchise taxes together when discussing the taxability of federal obligations. *See, Shapiro* v. *United States,* 335 U.S. 1 (1948).

Nonetheless, this court shall consider legislative history and other federal statutes in an effort to determine legislative intent with regard to Sec. 1433.

310 U.S.C., Sec. 3124(a)

The state contends that Sec. 1433 should be construed consistently with Sec. 3124(a), which provides that states may impose nondiscriminatory franchise taxes on federal obligations.[5]

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[4] The MNB does not specifically refer to *expressio unius est exclusio alterius,* as such.

[5] The predecessor of Sec. 3124(a) was 31 U.S.C. Sec. 742. There is no difference between Sec. 742 and its recodification in Sec. 3124(a).

The MNB responds, however, by asserting that FHLBBs are not obligations of the United States. That 12 U.S.C., Sec. 1435 specifically provides that FHLBBs "are not obligations of the United States."

To this the state replies that Sec. 3124(a) applies not only to treasury notes and bills, but also to obligations "of such instrumentalities of the United States as Federal Farm Credit Banks"[6] and that Federal Farm Credit Bank obligations are like FHLBBs. The MNB nevertheless points out that the FHLB Act is different because it does not provide that its banks are federal instrumentalities and because it provides that its bonds are "not obligations of the United States."

The state also cites two federal circuit cases which it says hold that FHLBs are federal instrumentalities.[7] However they are distinguishable.[8] Even if the FHLB is a federal instrumentality, *Memphis* did not rule that Sec. 3124(a) applied to all federal instrumentalities. And when Congress amended the predecessor of Section 3124(a) (i.e., Sec. 742) in 1958, it was presumed to be aware of its prior enactments, namely, that FHLBBs were "not obligations of the United States." So the 1959 amendment did not show a congressional intent that Sec. 3124(a) be applicable to FHLBBs.

Even if FHLBBs are obligations of the United States, Sec. 1433 is nevertheless controlling because the specific statute governing FHLBBs controls over the general provisions in Sec. 3124(a). To the extent that the statutes cannot be reconciled, the specific provision will prevail over

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[6] *Memphis Bk. and Tr. Co.* v. *Garner*, 459 U.S. 392 (1983).

[7] *Assn. of Data Proc. Serv. Orgs.* v. *FHLBB*, 568 F.2d 478, 480 (6th Cir. 1977) and *Fahey* v. *O'Melveny*, 202 F.2d 420, 446 (9th Cir. 1985).

[8] Neither considered whether Home Loan Banks were federal instrumentalities for purposes of Sec. 3124(a) or in the present context.

the general. *Morton* v. *Mancari,* 417 U.S. 435 (1974). *See also, Mertens* v. *Moore,* 108 Md. 636, 639 (1908).

But the state argues that the two statutes can be "harmonized," i.e., Sec. 1433 should be interpreted as if there was also an exception for franchise taxes. The state notes that in 1862 the original version of §742 was enacted exempting United States securities from all state taxation. It points out that a long line of Supreme Court cases construing that statute held that a franchise tax was nevertheless permitted because a franchise tax was imposed on the privilege of doing business, and not on the federal securities. The state then asserts that §1433 should be interpreted in the same manner the Supreme Court interpreted the original version of §742.

Sec. 1433 is distinguishable because it expressly provides an exception for certain privilege taxes that are not imposed directly on FHLBBs[9] but no exception was created for franchise taxes. The state nonetheless argues that the long line of cases decided under the original version of §742 established that privilege taxes do not constitute "taxation of federal obligations" and that franchise taxes are "not a tax on the bond." However, it is obvious that the prohibition of "all taxation" in §1433 *does* include privilege taxes. Otherwise there would have been no reason to provide an exception for inheritance, estate and gift taxes. The original version of §742 did not contain any specific exceptions, and the line of cases cited by the state are therefore not controlling under §1433.

The state also argues that nothing in §1433 shows that Congress acted to "expand" the exemption (provided in case law interpreting the original version of §742) by limiting the state's power to impose franchise taxes. However, §1433 did not "expand" an exemption because FHLBBs were a newly created bond. Also, the plain wording of

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[9] Inheritance taxes, estate taxes and gift taxes.

§1433 shows that Congress did intend to provide a broader exemption than that afforded some other bonds. With respect to the state's further argument that Congress did not intend to break with 60 years of "settled practice" regarding franchise taxes, it must be noted that because FHLBBs were new there was no "settled practice" with respect to the taxation of FHLBBs.

Finally, as to the state's argument that §1433 does not prohibit a state franchise tax because a franchise tax is a tax on a privilege, if that is true, then, as previously mentioned the parenthetical of exceptions for other privilege taxes would be rendered mere surplusage. The state's construction therefore conflicts with the established rule that no words in a statute should be construed to be mere surplusage. *American Bank & Trust, supra; Hirsch* v. *Maryland Department of Natural Resources,* 288 Md. 95 (1980).

12 U.S.C., Sec. 548

Sec. 548 authorizes states to impose a tax on national banking associations measured by their net income. It provides that for tax law purposes, a national bank should be treated as a state bank.[10] The state argues that Sec. 1433 should be construed to conform to Sec. 548.

Prior to 1969, §548 provided that a state tax on national banks could be measured by income from all sources, which was construed to authorize a franchise tax on national banks measured in part by existing tax immune federal

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[10] It provides that:

> For the purposes of any tax law enacted under authority of the United States or any State, a national bank shall be treated as a bank organized and existing under the laws of the State or other jurisdiction within which its principle [sic] office is located.

securities. The state thus argues that §548 grants the state authority to consider FHLBB income for franchise tax purposes.

However *American Bank* held that the state's authority under Sec. 548 is irrelevant if the state tax is prohibited by a different provision of federal law that a state tax that violates one federal law (there Sec. 742 and here Sec. 1433) cannot be imposed on a bank merely because the state tax does not also violate Sec. 548. Sec. 548 was intended to establish the extent to which states could tax national banks, and did not address the ability of the states to tax specific United States obligations such as FHLBBs. *American Bank, supra.* Moreover, the Federal Home Loan Bank Act was enacted in 1932, six years after Congress provided in §548 that states could tax national banks on income from all sources. Thus, when Congress provided that national banks could be taxed on income from all sources, those sources could not have possibly included FHLBBs because FHLBBs did not exist until 1932. Thus, §548 could not have been intended to permit a tax on FHLBBs. In 1932, when Congress enacted the Federal Home Loan Bank Act, it specifically provided in §1433 that new bonds (FHLBBs) would not be subject to state tax. The new statute did not conflict with §548 because §548 did not concern FHLBBs.

Again, even if §548 did otherwise apply to FHLBBs, the specific provision in §1433 barring state taxation of FHLBBs controls over the general provisions in Sec. 548. The state argues that if Sec. 1433 is interpreted to bar franchise taxes on FHLBBs, there would be a partial repeal of §548, and that repeals by implication are not favored. However, that when §548 was enacted there were no FHLBBs, and §1433 could therefore not have repealed any part of §548. When §1433 created new bonds under a new Act in 1932, it acted on a clean slate in exempting the bonds from state taxation. Because the bonds were new, §1433 could not have repealed any prior statute.

Legislative History of Sec. 1433

The state argues that the legislative history of the Federal Home Loan Bank Act demonstrates that Congress did not intend for FHLBBs to be exempt from state franchise taxes. The MNB counters by stating that Sec. 1433 is not ambiguous and hence courts should not examine legislative intent. *Ryder Truck Lines* v. *Kennedy,* 296 Md. 528 (1983).

The state further asserts that nothing in the legislative history suggests that Congress intended to create a special franchise tax immunity for FHLBBs. Further that Congress did not intend to make FHLBBs more attractive to investors than United States Treasury obligations. But Sec. 1433 does purport to bar a franchise tax on FHLBBs and that could well be, and probably was, the result of a congressional desire in 1932 to limit the ravages of the Great Depression. In other words, Congress acted to provide mortgage money for potential homeowners by enacting the FHLB Act. *Compare, Laurens F. S. & L. Assn.* v. *South Carolina Tax Comm.,* 365 U.S. 518, 522 (1961).[11]

The legislative history argument of the state is not felt to be persuasive.

Can Sec. 1433 reasonably be read to allow the state franchise tax in question?

To recapitulate, the arguments of the state are:

A. The expressio unius est exclusio alterius maxim

This has been dealt with, *see infra* at 2-4, even considering legislative history. *See infra* at 4-10.

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[11] Act set up federally chartered Home Loan Bank(s) to place long term funds in the hands of local institutions to alleviate the pressing need of home owners for 'low-cost, long-term' installment mortgage money and to "decrease cost of mortgage money" with a resulting benefit to home ownership in the form of lower costs and more liberal loans."

B. The expressio unius est exclusio alterius maxim does apply here because franchise taxes are not imposed directly on the bond.

But as previously discussed, FHLBs are not obligations of the United States (hence Sec. 742 does not apply) and even if they were, Sec. 1433 controls because it is more specific than the general Sec. 742. *See, infra* at 5. The *American Bank* case stresses that no words in a statute should be construed to be mere surplusage, but that is just what would happen if the state's argument were accepted. In other words, if Sec. 1433 were interpreted to ban a state franchise tax because a franchise tax is a tax on a privilege, the parenthetical of exceptions for other privilege taxes would thereby be rendered mere surplusage.

C. The Supreme Court[12] has construed a statute similar to Sec. 1433 to permit a state franchise tax, despite the enumeration of other exceptions.

But *Macallen* voided a state tax on a federal obligation because the state tax was actually an income tax, not a franchise tax imposed on a privilege, and because federal obligations are not subject to state income taxes. The obligations in question were federal farm loan bonds and liberty bonds. In light of its holding that no federal obligations of any kind could be included in an income tax, the court had no reason to examine the exemption statutes for the specific bonds in question. Thus the exemption statutes involved in *Macallen* were not construed to permit a franchise tax.

The state further argues that if the liberty bonds were statutorily exempt from franchise taxation in any event, the Court could have avoided the issue of whether the tax was an income tax or a franchise tax. But *Macallen* involved two different bonds and the farm loan bonds did not have an exemption statute similar to §1433. Thus, the

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[12] In *Macallen* v. *Mass.*, 279 U.S. 620 (1929).

Court could not have avoided the issue of whether the tax was an income tax or a franchise tax, because the farm loan bonds would have been subject to a franchise tax but not an income tax.

D. That farm credit banks take the position that their bonds are subject to state franchise taxes.[13]

But such position does not overrule *American Bank, State Ins.* v. *Nationwide,* 241 Md. 108 (1966) and *Penna. Nat. Mut. Cas. Ins. Co.* v. *Gartleman,* 288 Md. 151 (1980). These cases uphold the inference that the state seeks to eviscerate. And *Memphis* specifically left open the issue of whether the bonds of the Federal Credit Banks are subject to state franchise taxes.

E. An exception for franchise taxes in Sec. 1433 was unnecessary, at least for national bank holdings, since an exception already existed in Sec. 548.

But an exception for franchise taxes in §1433 was not unnecessary in light of §548, because §548 applied only to national banks, whereas FHLBBs are not owned solely by national banks. Secondly, even assuming that an exception for franchise taxes in §1433 was unnecessary in light of §548, the exception for inheritance, estate, and gift taxes in §1433 would have also been unnecessary. However, Congress deemed it necessary to include the latter exceptions, and these exceptions in §1433 should not be construed to be mere surplusage.

HOLDING

For the foregoing reasons the decision of the Maryland Tax Court, dated December 13, 1985 is, on this 2d day of October, 1986, affirmed and hence the MNB's claim for refund is and the same is hereby granted.

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[13] In an *amicus* brief in *Memphis Bk. & Tr. Co.* v. *Garner,* 459 U.S. 392 (1983).

INTEREST

The state agrees that interest should be paid if a refund is due but argues that interest should be paid under Art. 81, Sec. 218, which provides for interest at the rate of 6%. The MNB claims interest pursuant to Art. 81, Sec. 310(c), which provides that interest or refunds should be paid at a rate determined under Art. 81, Sec. 204—a higher rate naturally.

Sec. 218 deals with refunds of special taxes whereas Sec. 310 deals with refunds of income taxes. Art. 81, Sec. 6(7) defines "special taxes" specifically to include the "franchise tax on net earnings of financial institutions." The MNB argues that "net earnings" for the purpose of the franchise tax is computed by reference to the Income Tax Subtitle and is intertwined with the latter.

It further notes that the franchise tax statute[14]—provides:

> (3) The tax imposed by this Section shall be collected and administered by the Director in accordance with the provisions of the subtitle "Income Tax" of this article not inconsistent with this section.
>
> (4) Reference in the subtitle "Income Tax" to the Comptroller of the Treasury shall be taken to mean the Director for purposes of this section, and the Director shall have the same administrative and rule-making powers and duties with respect to the franchise tax imposed hereby as the Comptroller has with respect to income tax.

It then asserts that the administrative duties of the Comptroller with respect to refunding overpaid income taxes also apply to the Director of the State Department of Assessments and Taxation. So it argues that substitut-

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[14] Sec. 128A(e)(1985 Cum. Supp.).

ing the "Director" for the "Comptroller" in Sec. 310(a), as required by Sec. 128A(e), imposes the duty upon the Director to refund the overpayment of the franchise taxes pursuant to Sec. 310.

MNB's contention while interesting, is not persuasive. The plain meaning definition of "special taxes" to specifically include a "*franchise tax* on net earnings of financial institutions" (emphasis supplied) [Art. 81, Sec. 6(7)] is more persuasive. Accordingly, the state is directed to pay interest according to Art. 81, Sec. 218.

MARSHALL A. LEVIN
Marshall A. Levin
Judge

IN THE MARYLAND TAX COURT

Miscellaneous No. 549

MARYLAND NATIONAL BANK

vs.

STATE DEPARTMENT OF
ASSESSMENTS & TAXATION

ORDER

The above entitled case having come on for hearing, testimony having been taken and the matter considered, it is this 13th day of December, 1985, by the Maryland Tax Court ORDERED, that the action of the State Department of Assessments and Taxation in denying the Petitioner's claim for a refund of franchise tax be and the same is hereby REVERSED for the years 1979 through 1982.

cc: HERMAN B. ROSENTHAL, ESQ.
T. SCOTT BASIK, ESQ.
GENE L. BURNER, DIRECTOR
MARY JEAN LOPARDO, ESQ.

CERTIFIED TRUE COPY
Test: ROBERT L. ZOUCK, Clerk

NOTICE: You have the right of appeal from the above Order to the Circuit Court of any County or Baltimore City, wherein the property or subject of the assessment may be situated. The Order of Appeal

MUST be filed in the proper Court within thirty (30) days from the date of the above Order of the Maryland Tax Court.

IN THE MARYLAND TAX COURT

Miscellaneous No. 549

MARYLAND NATIONAL BANK

vs.

STATE DEPARTMENT OF
ASSESSMENTS & TAXATION

MEMORANDUM OF GROUNDS FOR DECISION

Petitioner, Maryland National Bank ("the Bank"), appears before this Court to contest disallowance of a refund in the amount of $197,310.94 for the years 1979-1982. Petitioner initially remitted this sum to Respondent as a portion of the franchise tax imposed by Article 81, Section 128A of the Maryland Code. The franchise tax is imposed upon Maryland financial institutions for the privilege of existing as corporations and is measured by their net earnings. During the subject years, the Bank, at Respondent's instruction, included in its net earnings interest income received on Federal Home Loan Bank Bonds. Petitioner contends that such inclusion was error because Federal law, which preempts State law by virtue of the Supremacy Clause of the U.S. Constitution, exempts such income from State taxation.

12 U.S.C. § 1433 provides in pertinent part that:

> "Any and all notes, debentures, bonds, and other such obligations issued by any bank, and consolidated Federal Home Loan Bank bonds and debentures, shall be exempt both as to principal and interest from all taxation (except surtaxes, estate, inheritance, and gift taxes) now or hereafter imposed by the United States, by any Territory, dependency, or possession thereof,

> or by any State, county, municipality, or local taxing authority."

The Bank argues that the plain meaning of the statute prohibits States from imposing franchise taxes measured in part by interest income generated by Federal Home Loan Bank Bonds. We believe that the Bank is correct.

Before proceeding to analyze 12 U.S.C. § 1433, we note that it is that provision and not 31 U.S.C. § 3124(a) (formerly § 742) which applies. The latter statute provides an exemption from State taxation for "stocks, bonds, Treasury notes, and other obligations of the United States." Among the exceptions to this exemption the statute lists nondiscriminatory franchise taxes. Section 3124 was enacted in its original form in 1862, long before the establishment of Federal Home Loan Banks in 1932. The two statutes, appearing in separate articles of the United States Code, appear to be unrelated. However, even if the phrase "other obligations of the United States" could be construed to include Federal Home Loan Bank Bonds, it is an accepted rule of statutory interpretation that the more specific provisions of 12 U.S.C. § 1433 would control the general provisions of 31 U.S.C. § 3124(a).

The State Department of Assessments and Taxation ("the State") argues that 12 U.S.C. § 1433 does not exempt interest income from inclusion in the net earnings upon which franchise taxes are imposed. This argument is based upon the historical development of the Federal tax exemption provisions.

The first statute to promulgate an exemption provided that "all stocks, bonds, and other securities of the United States . . . shall be exempt from taxation by or under state authority." Rev. Stat. § 3701, 31 U.S.C. § 742. However, soon after the passage of this statute, Supreme Court case law began to distinguish between impermissible taxes imposed directly upon Federal securities or the income derived therefrom, and permissible franchise, estate,

inheritance and similar taxes. The latter were viewed as taxes upon the privilege to engage in certain types of transactions, such as the operation of a business in corporate form or the transfer of one's property, which only incidentally took into account Federal securities. Accordingly, States were allowed to impose such taxes in spite of the exemption. See, for example, *Society for Savings v. Coite*, 73 U.S. (6 Wall.) 594 (1868) and *Plummer v. Coler*, 178 U.S. 115 (1900).

The State claims that Congress intended the well-established case law exceptions to the 1862 exemption statute to apply 12 U.S.C. § 1433 which it enacted in 1932. The State essentially argues that the exceptions Congress in fact wrote into the statute were surplusage and not intended as an exhaustive list. We cannot accept this argument.

First, the State's argument implies that Congress failed to accurately express its true intent through the words it in fact used in drafting the statute. Although this is not impossible, we are highly reluctant to attempt to second guess Congress. Unless there is strong evidence of a mistake or ambiguity we will not tamper with the plain meaning of the statute.

Secondly, the fact that well-established case law exceptions to other Federal exemption provisions existed at the time Congress drafted 12 U.S.C. § 1433 tends to show that when Congress included only certain of those exceptions and not others in the statute, only those exceptions included (and no others) should apply.

An examination of other exemption provisions found in Article 12 of the United States Code supports this position. For example, § 2055 relating to Federal Land Banks and Associations, provides in pertinent part:

> "The mortgages held by the Federal land banks and the notes, bonds, debentures, and other obligations

> issued by the banks or associations shall be deemed and held to be instrumentalities of the Government of the United States and, as such, they and the income therefrom shall be exempt from all Federal, State, municipal, and local taxation, other than Federal income tax liability of the holder thereof under the Public Debt Act of 1941 (section 742(a)[1] of Title 31)." (Footnote omitted.)

A slightly different exemption is provided by § 2290(a), relating to Federal Financing Banks, which reads:

> "(a) The Bank, its property, its franchise, capital, reserves, surplus, security holdings, and other funds, and its income shall be exempt from all taxation now or hereafter imposed by the United States or by any State or local taxing authority; except that (1) any real property and any tangible personal property of the Bank shall be subject to Federal, State, and local taxation to the same extent according to its value as other such property is taxed, and (2) any obligations issued by the Bank shall be subject to Federal taxation to the same extent as the obligations of private corporations are taxed."

Section 1825, relating to the Federal Deposit Insurance Corporation, provides in pertinent part:

> "All notes, debentures, bonds, or other such obligations issued by the Corporation shall be exempt, both as to principal and interest, from all taxation (except estate and inheritance taxes) now or hereafter imposed by the United States, by any Territory, dependency, or possession thereof, or by any State, county, municipality, or local taxing authority:"

We think it clear from the above quoted statutes that the exceptions written into § 1433 were not mere "boilerplate." Congress, for whatever reason, has granted varying forms of tax exemption to the different Federal bank

obligations it has authorized. Thus Congress said what it meant when it wrote that only surtaxes, estate, inheritance, and gift taxes may be imposed directly or indirectly on Federal Home Loan Bank Bonds. Franchise taxes are not included.

Respondent contends that the Supreme Court decided this issue in a manner favorable to it in *Macallen Co. v. Commonwealth*, 279 U.S. 620 (1929). That case dealt with the constitutionality of a Massachusetts excise tax measured by corporate net income. (The same concept as the franchise tax now under consideration before us.) Income derived from Liberty bonds and federal farm loan bonds which Congress had exempted from State taxation was included in this measurement. The Supreme Court struck down the state tax because legislative history made it clear that the Massachusetts legislature intended a direct tax on the bonds which it had "disguised" as an excise tax. Respondent argues that the Liberty bonds at issue were subject to a Federal exemption statute which excepted estate and inheritance taxes from its scope, but not franchise taxes. If this omission meant that the bonds were exempt from franchise tax, then the Supreme Court need not have reached the issue of the constitutionality of the Massachusetts statute for even if it was constitutional it could not apply.

However, the exemption statute which Congress enacted for Liberty bonds only listed exceptions for estate and inheritance taxes imposed by the *United States*. Act Sept. 24, 1917, Ch. 56, 40 Stat. 288,291 § 7 (31 U.S.C. § 747).(1)

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(1) The relevant excerpt of the statute reads:

> "All such bonds and certificates shall be exempt, both as to principal and interest, from all taxation now or hereafter imposed by the United States, any State, or any of the possessions of the United States, or by any local taxing authority, except (a) estate or inheritance taxes, and (b) graduated additional income taxes, commonly known as surtaxes, and excess profits and war-profits

None of the exceptions to the exemption applied to the States. Thus all of the case law exceptions, including that for franchise taxes, were applicable to the *State* tax exemption provision for Liberty bonds. This contrasts sharply to 12 U.S.C. § 1433 where Congress specified certain exceptions to State as well as Federal tax exemption, but not others.

Respondent further argues that the Supreme Court held in *Memphis Bank and Trust Co. v. Garner*, 459 U.S. 392, 397 (1983), that the exemption provisions in Article 12 of the United States Code are coextensive with that provided in 31 U.S.C. § 3124(a). This would mean that nondiscriminatory franchise taxes could be imposed upon a measurement of net earnings including income from Federal Home Loan Bank Bonds. However, we think that footnote 5([2]) cited by Respondent is dicta and thus cannot control our decision.

Accordingly, we shall pass an Order requiring the State to refund franchise taxes paid by Petitioner on interest income it derived from Federal Home Loan Bank Bonds during the subject years.

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taxes, now or hereafter imposed *by the United States* upon the income or profits of individuals, partnerships, associations, or corporations." (Emphasis added.)

([2]) The relevant excerpt of that footnote reads:

"5. In establishing the Federal Credit Banks, Congress made clear that the obligations of these banks would be immune from taxation by the States. 12 U.S.C. §§ 2055, 2079 and 2134. We have no occasion to determine whether the immunity described in these provisions is broader than that otherwise provided by 31 U.S.C. § 742. We note, however, that for purposes of federal tax immunity, our cases have made no distinction between the obligations of the U.S. Treasury and the obligations of the Federal Credit Banks."

MANDATE

Court of Appeals of Maryland

No. 6, September Term, 1987

STATE DEPARTMENT OF
ASSESSMENTS AND TAXATION

v.

MARYLAND NATIONAL BANK

Appeal from the Circuit Court for Baltimore City pursuant to certiorari to the Court of Special Appeals.
Filed: March 10, 1987.
April 24, 1987: Motion for protective order, filed by appellee and cross-appellant.
April 29, 1987: Above motion granted. Record to be sealed.
May 19, 1987: Letter from AG office regarding case.
October 6, 1987: Judgment of the Circuit Court for Baltimore City reversed. Case remanded to that Court for the entry of a judgment reversing the order of the Maryland Tax Court and remanding this case to the Maryland Tax Court for the entry of an order denying appellee's claim for refund. Costs to be paid by the appellee.
Opinion by Rodowsky, J.

STATEMENT OF COSTS:

In Circuit Court:

Record	$50.00
Stenographer's Costs	

In Court of Appeals:

Petition Filing Fee	$
Printing Brief for Appellant	192.00
Portion of Record Extract—Appellant Joint	124.80
Reply Brief & Cross-appellee	76.80

Appearance Fee—Appellant	10.00
Filing Fee on Appeal (Court of Special Appeals)	50.00
Printing Brief for Appellee	240.00
Portion of Record Extract—Appellee	
Appearance Fee—Appellee	10.00
Total Costs	$703.60

STATE OF MARYLAND, ss:

I do hereby certify that the foregoing is truly taken from the records and proceedings of the said Court of Appeals.

In testimony whereof, I have hereunto set my hand as Clerk and affixed the seal of the Court of Appeals this fifth day of November, 1987.

/s/ ALEXANDER L. CUMMINGS
Clerk of the Court of Appeals of Maryland.

Costs shown on this Mandate are to be settled between counsel and NOT THROUGH THIS OFFICE.

Filed November 27, 1987

IN THE COURT OF APPEALS OF MARYLAND

September Term, 1987

No. 6

STATE DEPARTMENT OF
ASSESSMENTS AND TAXATION
Appellant and Cross-Appellee

v.

MARYLAND NATIONAL BANK
Appellee and Cross-Appellant

**ON APPEAL FROM THE CIRCUIT COURT
FOR BALTIMORE CITY
(MARSHALL A. LEVIN, JUDGE)**

**NOTICE OF APPEAL TO THE
SUPREME COURT OF THE UNITED STATES**

Notice is hereby given that Maryland National Bank, the above-named Appellee, hereby appeals to the Supreme Court of the United States from the final judgment of this Court (reversing the judgment of the Circuit Court for Baltimore City) entered in this action on October 6, 1987.

This appeal is taken pursuant to 28 U.S.C. §1257(2).

/s/ H. THOMAS HOWELL
H. Thomas Howell

/s/ HERMAN B. ROSENTHAL
Herman B. Rosenthal

/s/ T. Scott Basik
T. Scott Basik

Semmes, Bowen & Semmes
250 W. Pratt Street
Baltimore, MD 21201
(301) 539-5040

ATTORNEYS FOR APPELLEE,
MARYLAND NATIONAL BANK

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on this 25th day of November, 1987, a copy of the aforementioned Notice Of Appeal To The Supreme Court of The United States was mailed, postage prepaid, to J. Joseph Curran, Jr., Attorney General, and Hugh G. Stevenson, Assistant Attorney General, at The Munsey Building, 2nd Floor, Seven North Calvert Street, Baltimore, Maryland 21202, Kaye B. Bushel, Assistant Attorney General, 301 West Preston Street, Baltimore, Maryland 21201, and to Sandra E. Banks, Clerk, Circuit Court for Baltimore City, 111 North Calvert Street, Baltimore, Maryland 21202.

/s/ Herman B. Rosenthal
ATTORNEY FOR APPELLEE,
MARYLAND NATIONAL BANK

IN THE MARYLAND TAX COURT

Misc. No. 549

MARYLAND NATIONAL BANK

Petitioner

v.

STATE DEPARTMENT OF ASSESSMENTS AND TAXATION

Respondent

STIPULATION OF FACTS

This is a Stipulation of Facts and is agreed upon by the consent of the parties. The contents of this Stipulation may be accepted as facts for the purposes of this case. All stipulated exhibits herein may be admitted as evidence without further proof of authentication. If such an exhibit is a copy of an original document, it shall be admissible in the same manner as if it were the original. Unless specifically stated otherwise, the parties (i) do not waive the right to object to the introduction into evidence of any stipulated facts or exhibits on the ground of materiality or relevancy; (2) do not waive the right to introduce evidence inconsistent with the contents of stipulated exhibits, but (3) do waive the right to introduce evidence inconsistent with the stipulated facts and the authenticity of stipulated exhibits.

The following stipulations relate to the years 1979, 1980, 1981 and 1982, unless otherwise stated. The years 1979 through 1982 are referred herein as the "years in question."

1. During the years in question, Maryland National Bank was a financial institution subject to the Maryland franchise tax on net earnings of financial institutions imposed

by Md. Ann. Code Art. 81, Section 128A (1975 Repl. Vol., 1979 Cum. Supp., 1980 Repl. Vol., and 1981 and 1982 Cum Supps.)(the "franchise tax"). The tax enacted by Chapter 452, Laws of 1968 and codified as Article 81, §128A is, in fact, a franchise tax.

2. During the years in question, the Petitioner filed franchise tax returns (Respondent's Form SDAT 26) with Respondent completed in accordance with the instructions on the return. Copies of Petitioner's franchise tax returns for years 1979 through 1982 are attached hereto as Exhibits One through Four, respectively.

3. During the years in question, Respondent's Form SDAT 26 required Petitioner, in determining its net earnings subject to the franchise tax in any of such years, to include in such net earnings the amount of interest earned on its holdings of (i) obligations of the United States, its agencies and instrumentalities ("United States Obligations"), and (ii) obligations of the State of Maryland and its agencies and political subdivisions ("Maryland obligations").

4. The Petitioner filed timely claims for refund of the franchise tax paid, *inter alia*, on interest received on United States Obligations. Copies of Petitioner's claims for refund are attached hereto as Exhibits Five and Six.

5. The Respondent denied Petitioner's claims for refund of the franchise tax by letter dated May 29, 1984, a copy of which is attached hereto as Exhibit Seven.

6. The Petitioner requested a Departmental hearing as to its denied refund claims which hearing was held on August 14, 1984. By letter dated September 10, 1984, from J. Kevin Mueller, State Supervisor/Personal Property, a copy of which is attached hereto as Exhibit Eight, the Respondent denied Petitioner's claims for refund of the franchise tax.

7. The parties agree that the only interest income at issue with respect to Petitioner's refund claims is that received on the following obligations all of which are Federal Home Loan Bank Bonds described by the Petitioner's tax year during which the indicated principal amount of the obligation was held, its due date, the date of acquisition by Petitioner, and the amount of interest income included by Petitioner in its net earnings for purposes of the franchise tax during each of the years in question:

Year	Principal Amount (in millions)	Due	Acquired	Interest
1979	3	8/25/81	12/5/79	26,650.00
1980	3	8/25/81	12/5/79	369,000.00
1980	2	7/27/81	3/26/80	241,388.90
1980	1	7/27/81	3/25/80	121,133.34
1980	1	7/27/81	3/27/80	120,255.55
1980	1	8/25/81	3/11/81	99,083.33
1980	4	10/26/81	3/21/80	399,777.79
1981	2	7/27/81	3/26/80	180,822.22
1981	1	7/27/81	3/25/80	90,411.11
1981	1	7/27/81	3/27/80	90,411.11
1981	1	8/25/81	3/11/80	79,950.00
1981	3	8/25/81	12/5/79	239,850.00
1981	4	10/26/81	3/21/80	421,194.44
1982	3	12/27/83	4/7/82	338,800.00
				2,818,727.79

8. The Federal Home Loan Bank Bonds described in Stipulation Number 7 represent "consolidated Federal Home Loan Bank bonds" issued after 1935 pursuant to the provisions of 12 USCA Section 1431 (West 1956 and Supps. 1979-1982).

9. The parties agree that, if Petitioner is awarded a refund of the franchise taxes paid during the years in question, the Petitioner is entitled to refunds in the following amounts (plus such interest as is provided by law).

Year	Interest on Federal Home Loan Bank Bonds	Franchise Tax Paid (.07 x interest)
1979	$ 26,650.00	$ 1,865.50
1980	1,350,638.91	94,544.72
1981	1,102,638.88	77,184.72
1982	338,800.00	23,716.00
	$2,818,727.79	$197,310.94

/s/ HERMAN B. ROSENTHAL
Herman B. Rosenthal

/s/ KAYE BROOKS BUSHEL
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DATED: June 12, 1985